

Estimated Sustainable Growth Rate and Final Conversion Factor, for Medicare Payments to Physicians in 2001

Section 1848 of the Social Security Act requires the Secretary to make available to the Medicare Payment Advisory Commission (MedPAC) and the public by March 1 of each year, an estimated Sustainable Growth Rate (SGR) and estimated conversion factor applicable to Medicare payments for physician services for the following year and the data underlying these estimates. Earlier in 2000, we provided the estimates and information applicable to physician fee schedule payments in calendar year 2001 to Medpac and to the public via this web page. We are now updating the web page to be consistent with information contained in our November 1, 2000 *Federal Register* publication and to provide updated expenditure data. It is important to note that the SGRs are *estimated* and may be revised based on later data.

Medicare Sustainable Growth Rate

Section 1848(f) of the Social Security Act (the Act), as amended by section 4503 of the Balanced Budget Act of 1997 (BBA) (Pub. L. 105-33), enacted on August 5, 1997, replaced the Medicare Volume Performance Standard (MVPS) with a Sustainable Growth Rate (SGR) provision. Section 211 of the Balanced Budget Refinement Act of 1999 (BBRA) revised the SGR. Section 1848(f)(2) of the Act specifies the formula for establishing yearly SGR targets for physicians' services under Medicare. The use of SGR targets is intended to control the growth in aggregate Medicare expenditures for physicians' services.

The SGR targets are not direct limits on expenditures. Payments for services are not withheld if the SGR target is exceeded by actual expenditures. Rather, the fee schedule update, as specified in section 1848(d)(3) of the Act, is adjusted to reflect the comparison of actual expenditures to target expenditures. If expenditures exceed the target, the update is reduced. If expenditures are less than the target, the update is increased. Under the statute, the update for a year is determined by comparing cumulative actual expenditures to cumulative target expenditures (referred to as "allowed expenditures" in the statute) from April 1, 1996 through the end of the year preceding the year at issue. For instance, the 2001 update will reflect a comparison of cumulative actual to cumulative target expenditures from April 1, 1996 through December 31, 2000. Target expenditures for each year are equal to target expenditures from the previous year increased by the SGR (which is a percentage figure computed by combining four factors specified below).

The statute specifies a formula to calculate the SGR based on our estimate of the change in each of four factors. The four factors for calculating the SGR are as follows:

- (1) The estimated percentage change in fees for physicians' services.
- (2) The estimated change in the average number of Medicare fee-for-service beneficiaries.
- (3) The estimated projected growth in real gross domestic product (GDP) per capita.
- (4) The estimated change in expenditures due to changes in law or regulations.

Section 1848(d)(1)(E) of the Act requires publication in the *Federal Register* no later than November 1 of each year (beginning with 2000) of the actual conversion factor, update and allowed expenditures that will apply to physicians' services for the succeeding year. Another section of the law (section 1848(f)(1)) requires that we publish in the *Federal Register* no later than November 1 of a year, using the best available data as of September 1, the SGR for the following year, the contemporaneous year, and the preceding year. The law includes special provisions for 2000. On November 1, 2000, based on the best data available to us as of September 1, 2000, we published the SGR for FY 2000, CY 2000 and CY 2001. In that notice, we provided (i) our current estimates of the SGRs for FY 2000, CY 2000 and CY 2001, (ii) our current estimates of allowed expenditures under the SGR system through the end of 2001, and (iii) the calculation of the physician fee schedule update for 2001.

Table 1 shows our current estimates of the components of the aforementioned SGRs.

Table 1. Current Estimates of SGR's for FY 2000, CY 2000, and CY 2001

	FY 2000	CY 2000	CY 2001
Factor 1: Increase in Fees	2.1%	2.1%	1.9%
Factor 2: Increase in Enrollment	0.8%	1.0%	0.9%
Factor 3: Increase in Real Per Capita GDP	4.5%	4.3%	2.7%
Factor 4: Increase due to changes in Law or Regulations	0.3%	0.5%	0.0%
Total Sustainable Growth Rate	7.9%	8.1%	5.6%

There may be differences between an SGR for a year estimated by November 1 of the prior and the SGR for the same year as subsequently revised based on later data. Section 1848(f) of the Act requires adjustment of prior years' SGR component factors, to reflect later data, beginning with the SGR for FY 2000. The two SGR elements that have exhibited the most volatility have been the fee-for-service enrollment numbers and real gross domestic product per capita.¹ With data on these factors during the year after March 1, interested persons could make estimates of the SGR and the performance adjustment to the physician update for a year.

The MVPS/SGR targets for periods prior to FY 2000 are listed in Table 2 below. The MVPS applied for FY 1990 through FY 1997. The SGR applied beginning with FY 1998. Figures reflect a weighted average MVPS for FY 1991 through FY 1993 when there were two different MVPSs (one for surgical services, and one for all other services) and for FY 1994 through FY 1997 when there were three different MVPSs (for surgical services, primary care services, and all other services).

Table 2 Physician MVPS / SGR

Year	Physician MVPS / SGR
FY 1990	9.1%
FY 1991	7.3%
FY 1992	10.0%
FY 1993	10.0%
FY 1994	9.4%
FY 1995	7.5%
FY 1996	1.8%
FY 1997	-0.3%
FY 1998	1.5%
FY 1999	-0.3%

Allowed Expenditures for Physicians Services

Section 1848(d)(3)(C) of the Act defines allowed expenditures for the period April 1, 1996 through March 31, 1997 to be equal to actual expenditures for physicians services during that period. Annual allowed expenditures for subsequent periods are equal to annual expenditures for the previous year increased by the SGR. The SGR was determined on a fiscal year basis through FY 1999. Beginning with CY 2000, the SGR is determined on a calendar year basis. The BBRA provides for a transition from a fiscal year to a calendar year SGR system in 1999. We have described this transition in a *Federal Register* notice published in April 10, 2000.

Table 3 shows quarterly allowed expenditures and cumulative allowed expenditures for the period from April 1, 1996 through December 31, 2001. The table shows quarterly allowed expenditures for physician services to reflect any seasonality which may occur in expenditures for physician services over a year. For instance, there is a different figure for quarterly allowed expenditures for the four quarters included in the April 1, 1996 to

¹ We note that more recent data on these two elements are available during a year on several web sites. The latest measurements of real GDP for a quarter is available from the home page for the Bureau of Economic Analysis of the Department of Commerce (www.bea.doc.gov). Population figures are available from the home page for the Census Bureau (www.census.gov). Real GDP per capita can be calculated from these figures. In addition, monthly M+C enrollments are currently available on the HCFA Home page (www.hcfa.gov/stats.mmcc.htm). In April of each year, when our Office of the Actuary puts the Trustees Report on the HCFA Home page, we will also post the projections of total Medicare Part B enrollment for the current and subsequent calendar years, as well as for the preceding calendar year, consistent with the Trustees Report. Thus, Medicare fee-for-service enrollment could be determined.

March 31, 1997 base period. We provide more information in the footnote to Table 3 on how quarterly figures are combined to determine allowed expenditures for a year.

Table 3. Summary of Allowed Expenditures for Physicians Services¹

Quarter	Applicable SGR	Quarterly Allowed Expenditures ² [in billions]	Cumulative Allowed Expenditures ³ [in billions]
2Q1996		\$12.3	\$12.3
3Q1996		\$12.0	\$24.3
4Q1996		\$12.2	\$36.5
1Q1997		\$12.3	\$48.9
2Q1997	1.5%	\$12.5	\$61.4
3Q1997	1.5%	\$12.1	\$73.5
4Q1997	1.5%	\$12.4	\$86.0
1Q1998	1.5%	\$12.5	\$98.5
2Q1998	-0.3%	\$12.5	\$111.0
3Q1998	-0.3%	\$12.1	\$123.1
4Q1998	-0.3%	\$12.4	\$135.5
1Q1999	-0.3%	\$12.5	\$147.9
2Q1999	7.9%	\$13.5	\$161.4
3Q1999	7.9%	\$13.1	\$174.5
4Q1999	7.9%	\$13.4	\$187.8
1Q2000	8.1%	\$13.5	\$201.3
2Q2000	8.1%	\$14.6	\$215.9
3Q2000	8.1%	\$14.1	\$230.0
4Q2000	8.1%	\$14.4	\$244.4
1Q2001	5.6%	\$14.2	\$258.7
2Q2001	5.6%	\$15.4	\$274.1
3Q2001	5.6%	\$14.9	\$289.0
4Q2001	5.6%	\$15.2	\$304.2

¹As explained above, the law requires revisions of SGRs beginning with the FY 2000 SGR. Since the quarterly and cumulative allowed expenditures for the last 3 quarters of CY 1999 are based on the FY 2000 SGR, these figures are estimated and may change based on more recent information which affects the FY 2000 SGR. The 2000 figures (based on the CY 2000 SGR) and the 2001 figures (based on the CY 2001 SGR) may also change based on revisions to these SGRs.

²Allowed expenditures a quarter (such as 4Q2001) are equal to allowed expenditures for the same quarter in the previous year (4Q2000 in this example) increased by the SGR for the year in which that quarter occurs (in this case, 5.6 percent). For example, quarterly allowed expenditures of \$15.2 billion in 4Q2001 are equal to quarterly allowed expenditures of \$14.4 billion (4Q2000) increased by the SGR of 5.6 percent (\$15.2 billion = \$14.4 billion x 1.056).

³Cumulative allowed expenditures for a quarter (such as 4Q 2001) are equal to the sum of cumulative allowed expenditures from the previous quarter for the same year (3Q2000) and quarterly allowed expenditures for that quarter. For example, cumulative allowed expenditures in 4Q2001 of \$304.2 billion are equal to the sum of cumulative allowed expenditures through 3Q2001 of \$289.0 billion and estimated allowed expenditures in 4Q2001 of \$15.2 billion (\$304.2 billion = \$289.0 billion + \$15.2 billion).

Note: Totals do not necessarily equal the sum of rounded components.

Actual Expenditures for Physicians Services

Table 4 shows, on a quarterly basis from April 1, 1996 through June 30, 2000, actual expenditures and cumulative actual expenditures for the period. These expenditures represent reimbursement amounts tabulated by the quarter in which the service was furnished. Since there is a lag between the date that the service is furnished and the date that the payment is made, data for the most recent quarters are incomplete. The total reimbursement amounts for these quarters are estimated by approximating the level of completeness of the data using historical trends. We will update these amounts periodically when we have reasonably complete data (approximately 6 months after the end of a quarter). As we have described above, we are showing actual expenditures on a quarterly basis to reflect any seasonal variation in expenditures that occurs over the year.

Table 4. Summary of Actual Expenditures under the SGR

Calendar Quarter	Benefits Processed thru 6/30/2000 [in billions]	Approximate Completeness	Estimated Total Expenditures ¹ [in billions]	Cumulative Total Expenditures ¹ [in billions]
2Q1996	\$12.3	100.0%	\$12.3	\$12.3
3Q1996	\$12.0	100.0%	\$12.0	\$24.3
4Q1996	\$12.2	100.0%	\$12.2	\$36.5
1Q1997	\$12.3	100.0%	\$12.3	\$48.9
2Q1997	\$12.5	100.0%	\$12.5	\$61.4
3Q1997	\$12.1	100.0%	\$12.2	\$73.6
4Q1997	\$12.2	100.0%	\$12.2	\$85.7
1Q1998	\$12.3	99.9%	\$12.3	\$98.1
2Q1998	\$12.3	99.8%	\$12.3	\$110.4
3Q1998	\$12.0	99.7%	\$12.0	\$122.4
4Q1998	\$12.2	99.2%	\$12.3	\$134.7
1Q1999	\$12.3	98.3%	\$12.5	\$147.3
2Q1999	\$12.4	96.9%	\$12.8	\$160.0
3Q1999	\$12.1	96.2%	\$12.6	\$172.6
4Q1999	\$12.3	95.5%	\$12.9	\$185.5
1Q2000	\$12.9	95.3%	\$13.5	\$199.0
2Q2000	\$9.1	65.7%	\$13.9	\$212.9

¹Estimated and cumulative total expenditures are less likely to change as the approximate completeness approaches 100 percent.

Note: Totals do not necessarily equal the sum of rounded components.

CY 2001 Physician Fee Schedule Update and Conversion Factor

The physician fee schedule conversion factor is updated each year by the percentage change in the Medicare Economic Index (MEI), which measures the weighted average price change for various inputs involved with producing physicians services. The fee schedule update is adjusted by a performance adjustment factor which compares actual and target expenditures. The performance adjustment factor for a given year is determined by a statutory formula, as shown below.

For the 2001 physician fee schedule update, the law requires that the performance adjustment factor (PAF) be calculated using the following formula:

$$PAF_{2001} = \frac{\text{Target}_{2000} - \text{Actual}_{2000}}{\text{Actual}_{2000}} \times 0.75 + \frac{\text{Target}_{4/96-12/00} - \text{Actual}_{4/96-12/00}}{\text{Actual}_{2000} \times (1 + SGR_{2001})} \times 0.33$$

Substituting the estimated figures from tables 1, 3, and 4, as well as our current projections of actual expenditures for CY 2000 (summarized below) in this formula produces the PAF for 2001:

Target₀₀ = Estimated Allowed Expenditures for CY 2000 = \$56.6 billion (\$13.5 + \$14.6 + \$14.1 + \$14.4)

Actual₀₀ = Estimated Actual Expenditures for CY 2000 = \$55.1 billion

Target_{4/96-12/00} = Estimated Cumulative Allowed Expenditures from 4/1/1996 - 12/31/2000 = \$244.4 billion

Actual_{4/96-12/00} = Estimated Cumulative Actual Expenditures from 4/1/1996 - 12/31/2000 = \$240.6 billion

SGR₂₀₀₁ = Estimated Sustainable Growth Rate for 2001 = 5.6 percent or 0.056

$$PAF_{2001} = \frac{56.6 - 55.1}{55.1} \times 0.75 + \frac{244.4 - 240.6}{55.1 \times 1.056} \times 0.33 = 0.042 = 4.2\%$$

Since section 1848(d)(3)(D) of the Act does not allow the performance adjustment factor for a given year to be greater 3.0 percentage points nor less than -7.0 percentage points, the performance adjustment factor for 2001 is 3.0 percentage points.

The estimated physician fee schedule update for CY 2001 is determined by multiplying (i) the estimated MEI, (ii) the estimated performance adjustment factor. This produced a 2001 update of approximately 5.2 percent ($1.05163 = 1.021 \times 1.03$).

There are three other adjustments to the 2001 conversion factor that must be applied to this figure. First, section 1848(d)(3)(F) of the Act requires a transitional adjustment to the updates for 2001 through 2005 to provide for budget neutrality in moving to the SGR as it was revised in the BBRA. The statute provides for an adjustment of -0.2 percentage (0.998) points for 2001. Second, since 1996, we have applied the budget-neutrality adjustment required under section 1848(c)(2)(B)(ii) for changes in relative value units, to the conversion factor, rather than rescaling relative values units for all services. For 2001, a budget-neutrality adjustment of -0.3 percent (0.997) is needed to accommodate the separate payment for certification and recertification of a plan of care for home health services. We are also incorporating a volume and intensity adjustment of -0.14 percent (0.9986) to account for the third year of the transition to the resource-based practice expenses system. Incorporating these adjustments, the conversion factor applicable to 2001 is \$38.2581 ($\$38.2581 = \$36.6137 \times 1.05163 \times 0.998 \times 0.997 \times 0.9986$).

Table 5. CY 2001 Physician Conversion Factor

CY 2000 Conversion Factor		\$36.6137
MEI	2.1% (1.021)	
Performance Adjustment	3.0% (1.030)	
CY 2001 Update		5.2% (1.05163)
Legislative Adjustment ¹	-0.2% (0.998)	
Volume and Intensity Adjustment ²	-0.14% (0.9986)	
Other Factors ³	-0.3% (0.997)	
Combined Adjustment		-0.6% (0.99361)
Total Increase		4.5% (1.04491)
CY 2001 Conversion Factor		\$38.2581

¹Section 1848(d)(4)(F) requires an adjustment to the conversion factor of -0.2 percent in 2001-2004 and +0.8 percent in 2005.

²As indicated in the physician fee schedule final rule published on November 2, 1998, we are also making a volume and intensity adjustment to reflect our actuarial assumption that physicians respond to payment reductions so as to offset 30 percent of reduction in physician fees. The 0.14 percent reduction reflects anticipated physician volume responses to payment reductions from the third year of transition to the resource-based practice expense relative value units. If the volume and intensity response does not occur, the sustainable growth rate system returns the offsetting reduction in the conversion factor in the form of higher future updates to the Medicare physician fee schedule.

³As indicated in the physician fee schedule final rule published on November 1, 2000, we are making a 0.3 percent reduction in the conversion factor to account for separate payment for certification and recertification of a plan of care for home health services.

Table 6 lists the historical MEI and physician updates from 1992 through 2001. The physician update reflects a weighted average for 1993 when there were two different updates (one for surgery and one for other services). The physician update reflects a weighted average for 1994 through 1998 when there were three different updates (for surgery, primary care, and other services).

Table 6. Actual Past MEI and Physician Updates for 1992-2001

Year	Physician MEI	Physician Update
Actual:		
1992	3.2%	1.9%
1993	2.7%	1.4%
1994	2.3%	7.0%
1995	2.1%	7.5%
1996	2.0%	0.8%
1997	2.0%	0.6%
1998	2.2%	2.3%
1999	2.3%	2.3%
2000	2.4%	5.5%
2001	2.1%	5.2%
<u>Average Annual</u>		
1992-2001	2.3%	3.5%
<u>Cumulative</u>		
1992-2001	25.9%	40.0%

Questions on the information presented here may be addressed to:

Office of the Actuary
N3-01-21
Health Care Financing Administration
Baltimore, MD 21244

or

[dmmce@hcfa.gov]

Office of the Actuary
Health Care Financing Administration
November 21, 2000